



There are many issues to consider in managing a business.

# Chapter 3: Management—Legal Aspects, Taxes, and Insurance

There are many issues to consider in managing a business. This chapter will address the legal aspects of going into business, tax obligations, and insurance coverage.



## Forms of Organization

There are four common forms of a business organization—sole proprietorship, partnership, corporation, and limited liability company. A brief explanation of each, with advantages and disadvantages, follows.

### Sole Proprietorship

A sole proprietorship is a business that is owned by an individual who is solely responsible for all aspects of the business. The owner is personally responsible for all debts of the firm, even in excess of the amount invested in the business. All that is necessary to establish a sole proprietorship is to obtain the necessary local licenses. Sole proprietorship is the easiest of the legal structures to set up and is the most common small business legal structure.

#### Advantages

- Greatest freedom from regulation
- Minimal working capital requirements
- Owner in direct control
- All profits to owner
- Tax advantage to owner
- Ease and speed of formation
- Low start-up costs

#### Disadvantages

- Unlimited liability
- Total responsibility
- Difficulty in raising capital

# Partnership

A general partnership is a legal entity that is jointly owned by two or more persons. As in the sole proprietorship, the owners are personally responsible for all debts of the firm, even those debts in excess of the amount invested in the business. An attorney should be consulted to help prepare the partnership agreement.

## Advantages

- Additional sources of capital
- Help in decision making
- Ease of formation
- Broader management base
- Relative freedom from government control and special taxation
- Share in profits
- Flexibility

## Disadvantages

- Organizational problems
- Unlimited liability of at least one partner
- Difficulty in raising additional capital
- Disposing of partnership interests

Limited partnerships must be filed with the State Corporation Commission (SCC). The requirements for establishing a limited partnership include filing a certificate that contains the name of the partnership, its specified office location, its registered agent, and the name of each general partner. Any limited partnership formed before January 1, 1987, is not subject to the filing requirements until there is a need to amend the certificate currently on file in the local circuit court. When such a change is necessary, the limited partnership will file an amended and restated certificate with the SCC. The law requires that no two limited partnerships on record at the SCC should have the same name; therefore, existing partnerships could potentially lose the name under which they are now operating.

# Corporation

A corporation is a business that is formed and authorized by law to act as a single person, although constituted by one or more persons, and is legally endowed with rights and responsibilities. There are two general types of corporations: regular and Subchapter-S. Each has numerous variations.

The regular corporation is the better-known corporate structure. This type of corporation requires several procedures: obtaining a corporate taxpayer identification number from the Internal Revenue Service (IRS), obtaining a state certificate of incorporation, and holding

a stockholders' meeting to elect directors who in turn elect the corporate officers. Each corporation must hold a stockholders' meeting at least once each year, keeping minutes of the meeting on the record. A corporation is either publicly held or closely held, usually depending on the number of stockholders. A closely held corporation is generally one where all the stock is owned by persons, or members of their immediate family, who are actively involved in the management of the business. This kind of corporate structure provides liability protection, the benefits of being incorporated, and the absence of public scrutiny applied to a partnership.

Another form of corporation is the Subchapter-S corporation. A new venture can have no more than 75 shareholders and no more than 20 percent of its income earned from passive investments. The losses of the corporation can be deducted by the individual stockholders and can be earned forward or backward to offset any gains. This is a significant advantage in attracting capital from individual investors who want a tax write-off the first several years when the corporation is losing money. When the new venture starts to earn a profit, the structure can be changed from a Subchapter-S corporation to a regular corporation with its accompanying tax laws.

It is advisable to consult an attorney when organizing a corporation to assure full compliance with Virginia and federal laws. All corporations doing business in Virginia are required to file articles of incorporation and certain other documents with the SCC.

Corporations that do business in more than one state must comply with the federal laws regarding interstate commerce and with the various state laws.

### Advantages

- Limited liability
- Possible tax advantage
- Easier to raise capital
- Government regulations
- Increased resources available
- Corporate benefits
- Continuous existence

### Disadvantages

- Extensive recordkeeping necessary
- Government regulations
- Inability to take losses as personal deductions
- Lessened control
- Double taxation
- Annual meetings
- Annual filings

## Limited Liability Company

A limited liability company is an unincorporated association. Limited liability companies must be filed with the SCC. The requirements for establishing a limited liability company include filing articles of organization that set forth the name of the company, its principal office address, and its registered agent. All amendments must be filed with the SCC.

### Advantages

- Limited liability for each member
- No limitation on size, type, or number of members
- Partnership tax status
- Flexibility
- Members may change

### Disadvantages

- Restrictions on transferability of membership rights

There are variations of these four forms of business organizations. It may be advisable to consult an attorney to assure that the form of organization you choose will best meet your needs. See State Corporation Commission in the Appendix.

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## Taxation

Every person engaged in a business activity is affected to some degree by local, state, and federal tax laws. Business activities that operate for a profit may produce a tax liability, whether the enterprise is a sole proprietorship, a partnership, a corporation, or a limited liability company. The assistance of an accountant may be advisable in determining which taxes your business will be responsible for paying.

### Annual Registration Fee

Every stock corporation organized under Virginia law pays an annual registration fee based on the number of authorized shares of stock shown in its charter. The fee is assessed by the SCC and is payable to the State Treasury at the end of the month that a corporation became incorporated. For fewer than 5,000 authorized shares, the fee is \$100. For more than 5,000 authorized shares, the fee is \$100 for the first 5,000 shares, plus \$30 for each 5,000 shares or fraction thereof, to a maximum of \$1,700. (Note: Annual registration fees paid by stock corporations doubled as of July 1, 2002.) Every limited partnership and limited liability company organized under Virginia law pays an annual registration fee of \$50, which is due on or before September 1 of each year. See State Corporation Commission in the Appendix.

## Business Tax

The business tax is a privilege tax levied by cities and counties in Virginia for the right to do business in their domain. Rates vary for different localities. For further information, call the Director of Finance or the Commissioner of Revenue in your locality.

## Corporate Taxes

### *General Liability*

Every corporation organized under the laws of Virginia and every foreign corporation registered with the State Corporation Commission for the privilege of doing business in Virginia or receiving income from Virginia sources must file a corporation income tax return except: public service corporations (other than electric and gas suppliers, railroads, and telecommunications companies), banks subject to the Bank Franchise Tax, credit unions, insurance companies, and corporations not conducted for profit which are exempt from United States income tax, with the exception that these are taxable on their unrelated business taxable income. Electing small business corporations (S corporations) are required to file a return of income even though they are exempt from Virginia income tax.

Income of a multistate corporation is determined by a double-weighted sales factor in which the sales factor is weighted 50 percent and the payroll and property factors are 25 percent each. The double-weighted sales factor is effective for taxable years beginning on or after January 1, 2000, provided a certain level of tax relief is attached by the Personal Property Tax Relief Act of 1998; otherwise, the income of a multistate corporation is determined by a three-factor formula of sales, payroll, and property. Special formulas are provided for motor carriers, financial corporations, railway companies, and construction corporations using the completed contract method of accounting.

### *Filing Procedure*

VATAX Online for Businesses offers businesses the ability to perform various Department of Taxation functions online, including registering a business and filing and paying many business taxes. See VATAX Online for Businesses on page 23.

**Registration:** Every corporation that is required to file an income tax return must register by filing a Business Registration Application, Form R-1, with the Virginia Department of Taxation. Registration can be done online using iReg at [www.tax.virginia.gov](http://www.tax.virginia.gov). The form can also be downloaded and mailed to PO Box 1114, Richmond, VA 23218-1114. No application fee is required.

**Filing of Returns:** A corporation income tax return must be filed and the tax paid with the Virginia Department of Taxation on or before the 15th day of the fourth month following the close of the corporation's taxable year. (The tax year is the same as that used for federal income tax purposes.)

**Extensions:** A six-month extension may be obtained by filing an application and paying a tentative tax. A copy of the federal extension must be attached to the Virginia extension. Corporate extensions are filed online at VATAX Online for Businesses at [www.tax.virginia.gov](http://www.tax.virginia.gov).

**Estimated Tax:** A corporation subject to Virginia income tax is required by law to make a declaration of estimated income tax if its Virginia income tax for the taxable year can reasonably be expected to exceed \$1,000. A corporation whose accounting period is a calendar year is required to make a declaration of estimated tax and pay one-fourth of such estimated tax directly to the Virginia Department of Taxation by April 15 of the taxable year. Subsequent installments are due June 15, September 15, and December 15. Corporate estimated payments can be paid online at VATAX Online for Businesses at [www.tax.virginia.gov](http://www.tax.virginia.gov).

A corporation whose accounting period is a fiscal year is required to make a declaration of estimated income tax and pay one-fourth of the tax directly to the Virginia Department of Taxation by the 15th day of the fourth month following the beginning of its fiscal year. Subsequent installments are due the 15th day of the sixth month, the 15th day of the ninth month, and the 15th day of the 12th month following the beginning of the corporation's fiscal year.

### *Electronic Funds Transfer*

EFT involves the transfer of funds from your bank account to the state's bank account. This program is currently available for the following taxes: Sales and Use Tax, Out-of-State Use Tax Dealers, Employer Withholding Tax, and Corporation Income Tax. If your monthly tax liability for any one of these taxes exceeds \$20,000, you are required by law to pay by EFT for consolidated sales tax accounts. EFT is required when the total liability of all subsidiaries exceeds \$20,000 as reported by the parent company.

The Department of Taxation also encourages other businesses that do not have an average monthly liability of \$20,000 to voluntarily transmit their tax return payments by EFT. EFT not only saves check writing and mailing costs, but also ensures that your payment is made without the worry of a check being lost in the mail. For withholding payment submitted by EFT, the requirement to submit VA5 and VA15 tax forms are eliminated. See Department of Taxation in the Appendix.

## **Property Tax**

In Virginia, the property tax is levied at the local level as a tax on real and personal property. For more information concerning property taxes in your area, contact the Director of Finance or the Commissioner of Revenue in your locality.

## **Sales and Use Tax**

Generally, the tax rate is 5.0 percent (4.0 percent state tax and 1.0 percent local tax). Beginning July 1, 1998, nonprescription drugs and proprietary medicines were exempted from state sales and use tax. Beginning January 1, 2000, the Food Tax Reduction Program reduced the state sales and use tax rate on food purchased for human consumption from 3.5 percent to 3.0 percent. This rate reduction, however, does not affect the local tax rate on such food products.

Key exemptions to sales and use taxes include industrial manufacturing, utilities and heating fuel, certain non-profit organizations, and most services. Consumers are expected to pay a 4.5 percent use tax on items purchased outside of Virginia and brought into the state for use. This includes items purchased through mail order or items shipped to Virginia from retailers located outside of the state. There is no tax liability for individuals if mail order purchases total \$100 or less during a calendar year. See Department of Taxation in the Appendix.

## Unemployment Compensation Tax

All employing units in Virginia with either full-time or part-time employees are required to file with the Virginia Employment Commission form VEC-FC-27—Report to Determine Liability for State Unemployment Tax. If it is determined that the employing unit is liable for the reporting and tax provisions of the law, the employer will be notified. The amount of tax due is based on a specific percentage of taxable wages for the quarter of the year. This information must be reported to the agency on form VEC-FC-20. Taxes are payable solely by the employer. No part of the tax may be deducted from the employees' wages. See Virginia Employment Commission in the Appendix.

## Employer Tax Requirements

Depending on the nature of your business, you may have to file the following returns and statements during the calendar year:

### Federal

#### Form 941

Employer's Quarterly Federal Tax Return

#### Form 940

Federal Unemployment Tax Return

### State

Virginia offers individual and business VATAX Online at [www.tax.virginia.gov](http://www.tax.virginia.gov). The following services are included in VATAX / VEC Online for Businesses:

- iFile—File and pay Sales, Use, or Employer withholding taxes with the Virginia Department of Taxation
- iFile—File and pay Unemployment Taxes with the Virginia Employment Commission.
- Corporate Extension returns and payments with the Virginia Department of Taxation
- Corporate Estimated tax payments with the Virginia Department of Taxation
- Secure Messaging—Secure and confidential communication with the Virginia Department of Taxation
- Web Payments—Make a bill payment or Accelerated Sales Tax payment
- Form VA-5 (Employer's Return of Virginia Income Tax Withheld), VA-6 (Employer's Return of Virginia Income Tax Withheld), and Form 500 ES (Virginia Declaration of Estimated Income Tax) can also be downloaded.

### Miscellaneous Taxes

- Bank Franchise Tax
- Cigarette Tax

- Corn Assessment
- Cotton Assessment
- Egg Excise Tax
- Forest Products Tax
- Litter Tax
- Peanut Excise Tax
- Rolling Stock Tax on Railroads and Freight Car Companies
- Sheep Assessment
- Small Grains Assessment
- Soft Drink Excise Tax
- Soybean Assessment
- Tire Tax
- Writ Taxes

## **Other Taxes and Fees**

### **Department of Alcoholic Beverage Control**

- Alcoholic Beverage Taxes and Licenses

### **State Corporation Commission**

- Corporation Charter, Entrance, and Registration Fees
- License Taxes on Insurance Companies
- Registration and Renewal Fees for Franchises and Securities
- Rolling Stock Tax on Certain Motor Vehicle Carriers of Passengers
- Taxes on Public Service Corporations and Certificated Telephone Companies
- Annual Assessment Fees and Application/Filing Fees for State-Chartered Financial Institutions

### **Department of Motor Vehicles**

- Fuel Tax (Motor Vehicle)
- Registration and Titling Fee for Motor Vehicles
- Motor Vehicle Sales and Use Tax



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## Federal Regulations

### Employer's Federal Identification Number

All retail and wholesale and some service businesses are required to have a federal identification number. Applications can be obtained from your local IRS office. Persons doing business in areas where the IRS does not have offices should call (800) 829-1040 or (800) 829-FORM to have the applications sent to them. Request Form SS-4.

### Social Security Federal Insurance Contributions Act

Employers and employees each contribute equally to the Social Security Fund (FICA taxes). In January of 1991, the Medicare portion of FICA taxes was separated and given a higher taxable wage limit than the base portion of FICA. In 2006, FICA contributions are:

- Salary Level: Up to \$94,200
  - Employee contribution: FICA 6.2 percent + Medicare 1.45 percent = 7.65 percent
  - Maximum tax: \$7,206
- Salary Level: Total Salary
  - Employee contribution: Medicare only at 1.45 percent

Both tax rates and maximum tax would be doubled for self-employed persons who make both the employer and employee contributions to FICA taxes. For information on Social Security taxes, contact the Social Security Administration (SSA) at (800) 772-1213 between 7 a.m. and 7 p.m.

### Federal Minimum Wage and Hour Laws

Federal labor laws are administered in Virginia by the U.S. Department of Labor. Wage rates that apply for all non-exempt employees are:

- As of September 1, 1997, not less than \$5.15 an hour.
- One and one-half times regular pay for all hours worked in excess of 40 hours during a workweek.

See U.S. Department of Labor in the Appendix.

### Social Security Administration

The SSA processes applications for retirement, disability, survivor benefits, and Medicare under the Social Security Act. Additionally, the SSA receives and processes applications for Social Security numbers. See Social Security Administration in the Appendix.

### Federal Information Center

The Federal Information Center provides complete information by telephone on services available from federal agencies. Contact the center at (800) 688-9889, Monday through Friday, from 9:00 a.m. to 8:00 p.m.

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# Insurance

Business owners can use insurance as a way of managing risk in their business. Before beginning a new business, consider the various types of business insurance available. Particular business needs can be assessed by an insurance agent, and a tailor-made program can be established to handle specific needs within your budget limitations.

## Liability Insurance

Any business is subject to laws governing negligence—failing to exercise a degree of care that might be expected or required under your particular situation or circumstances. Liability insurance provides coverage for customers, employees, or anyone else with whom you have contact in the course of business, or who is on your property.

Liability insurance policies generally cover:

- Payments that are required due to accidental bodily injury or property damage to others that you cause
- Medical services necessary at the time of the accident
- Costs of defending lawsuits that allege negligence, including expenses in investigation and settlement
- The cost of judgments during an appeal

If you operate any vehicle as part of your business, you will be required to maintain automobile liability insurance. Product liability insurance refers to coverage for any product manufactured, or retailer of products, that may cause injury or damage to the user of the product. Services can cause damage and may be subject to product liability.

## Life and Health Insurance

Life and health insurance provides extra compensation to employees, owners, or the business itself for losses that are sustained as a result of illness or death. Most businesses carry this coverage for their employees in order to be competitive with other companies.

## Property Insurance

Property insurance protects against losses that may occur to your business property as well as office supplies, equipment, and products. Property coverage you may want to consider includes:

- Automobile damage collision insurance
- Comprehensive property insurance
- Crime insurance for theft, burglary, and/or robbery
- Fire insurance
- Flood insurance
- Glass insurance
- Hail and windstorm insurance

- Inland marine insurance (retailers and wholesalers highly susceptible to loss)
- Sprinkler leakage insurance
- Vandalism

### Special-Purpose Insurance

Additional coverage can be obtained to protect you against the potential of large losses. These include:

- Boiler and machinery insurance
- Business interruption/loss of rents insurance
- Credit insurance
- Fidelity insurance
- Key employee insurance
- Surety bonds (guarantee work according to contract)
- Transportation insurance

### Workers' Compensation Insurance

Virginia law requires that all employers with three or more employees provide workers' compensation coverage for accidents and occupational diseases. The cost of workers' compensation insurance varies by industry and occupation. The entire cost is paid by the employer. A publication, *Informational Guide for Employers*, is available and can be reviewed on the Virginia Workers' Compensation Commission's website at [www.vwc.state.va.us](http://www.vwc.state.va.us). See Virginia Workers' Compensation Commission in the Appendix.

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## Resources on Legal Aspects, Taxes, and Insurance

### Employer's Handbook: A guide to employer's rights and responsibilities under the Virginia Unemployment Compensation Act

The *Virginia Unemployment Compensation Act* contains the provisions under which Virginia's Unemployment Insurance Program is administered. Stemming from this Act is *The Regulations and General Rules Affecting Unemployment Compensation*. The *Employer's Handbook* is an attempt to explain the various statutory and procedural aspects of the program in nontechnical terms. The *Employer's Handbook* is available online at [www.VaEmploy.Com](http://www.VaEmploy.Com). See Virginia Employment Commission in the Appendix.

## **Virginia Tax Facts**

This free publication contains information to aid individuals, businesses, and other organizations in complying with the Virginia tax laws administered by the Department of Taxation. Other publications include: *Guidelines for Local Business, Professional and Occupational License Taxes*; *Virginia Corporation Income Tax Regulations*; and *Virginia Retail Sales and Use Tax Regulations*. See Department of Taxation in the Appendix.

## **Federal Tax Forms and Publications**

For appropriate federal forms and publications for businesses, contact the IRS at (800) 829-4933 or visit [www.tax.virginia.gov](http://www.tax.virginia.gov).

## **U.S. Small Business Administration (U.S. SBA) Publications**

As part of its mission to aid, counsel, and assist small businesses, the U.S. SBA has utilized its nationwide network of resources to collect information covering a multitude of business-related issues and provide this information to all interested individuals. Business development aids recommend methods and techniques for handling management problems and general business operations. Business development information, which is available on the U.S. SBA website, provides in-depth information on specific topics to give greater understanding. Some of the topics include:

- Crime Prevention
- Financial Management
- Management and Planning
- Marketing
- Personnel Management
- Products/Ideas/Inventions

See U.S. Small Business Administration in the Appendix.

## **VATAX Online Services**

The Virginia Department of Taxation's website at [www.tax.virginia.gov](http://www.tax.virginia.gov) provides businesses and organizations easy access to a variety of online services and information about taxes in Virginia. In addition to online services, the website provides access to information including the *Policy Library*, *Tax Code of Virginia*, *Legislative Summaries*, *Rulings of the Commissioner*, and publications including *Tax Facts*, *Annual Reports*, and the *Taxpayer Bill of Rights*.

## **VATAX Online for Self-Employed Individuals**

VATAX Online for Self-Employed Individuals offers most Virginians the ability to perform various functions directly with the Department of Taxation. There is no software to download or purchase, and the online services are available seven days a week, twenty-four hours a day. Customers can save their work and complete it later. In addition, the services are free, easy, fast, and convenient. VATAX Online is available to anyone who has filed Virginia income tax returns in the Commonwealth of Virginia for the 1999, 2000, 2001, and tax years following.

VATAX Online for Self-Employed Individuals allows taxpayers to:

- File their income tax returns
- Direct deposit their refunds
- Electronically transfer (withdraw) payment of tax due from their checking or savings account on a specified payment date
- File extensions
- File and pay quarterly estimated taxes
- Check status of refunds
- Pay bills online
- Correspond securely and confidentially with the Tax Department through our secure messaging system.

### ***VATAX Online for Businesses***

VATAX Online for Businesses offers businesses the ability to perform various functions directly with the Department of Taxation. There is no software to download or purchase, and the online services are available seven days a week, twenty-four hours a day. In addition, they reduce errors, are free, easy, fast, and convenient. Customers can save their work and complete it later.

VATAX Online for Businesses allows businesses to:

- File and pay Sales, Use, or Employer withholding taxes
- File and pay Corporate Extension returns and payments
- File and pay Corporate Estimated Tax payments
- Web payments—make a bill payment or Accelerated Sales Tax payment
- Warehouse payments—file the tax return ahead of tax due deadline and instruct TAX to take payments on the deadline date
- Secure messaging system—correspond securely and confidentially through a secure messaging system
- File and pay Unemployment Taxes with the Virginia Employment Commission.  
**iReg for Businesses** is an online service that allows new businesses to register for the following Virginia taxes:
  - Employer Income Tax Withholding
  - Corporation Income Tax
  - Sales and Use Taxes
    - Retail Sales and Use Tax (in-state dealers, i.e., dealers located in Virginia)
    - Use Tax (out-of state dealers, i.e., dealers located outside of Virginia)
    - Business Consumer's Use Tax

- Dealer's Aircraft Sales and Use Tax
- Motor Vehicle Fuel Sales Tax
- Tire Tax
- Vending Machine Sales Tax
- Dealer's Watercraft Sales and Use Tax
- Litter Tax
- Miscellaneous Taxes: Corn Assessment, Cotton Assessment, Egg Excise, Forest Products, Peanuts, Sheep Assessment, Small Grains Assessment, Soft Drinks Excise Tax, Soybean Assessment
- Unemployment Taxes with the Virginia Employment Commission

Immediately upon completion of online registration, businesses can receive their state tax identification number and certificate(s) of registration. See Department of Taxation in the appendix.

**There may be other returns and statements that your business needs to file. It is suggested that you consult an accountant, the Virginia Department of Taxation, and the IRS to determine other reports that may be necessary.**